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Conditions, warranties and innominate terms – different terms for the same?

0. Introduction

The category of innominate terms was created in Hongkong Fir Shipping co. Ltd. V Kawasaki Kiten Kaisha Ltd.. One important role for the law of contract is to provide certainty in the planning of business relationships. The traditional categories of terms, for example, were quite sufficient and gives effect to the intention of the parties without an urgent need to disturb the predictability of outcome that they had always provided. The essay will analyse whether the creation and application of a new category of terms – innominate terms - causes uncertainty both for business people and their advisers.

1. Historical Background – the principle to classify into "conditions" and "warranties"

Contract terms – as far as of interest here – are traditionally classified by the English authorities for a very long period into two categories, "conditions" on one hand and "warranties" on the other.[1] The distinction was applied by all Commonwealth courts (see for Australia *Bowes v Chaleyer*[2]) and other legal systems related to common law (see for the US *Lowber v Bangs*[3]).
A condition in the technical sense of the law means a term of contract of essence and substantiality. Correspondingly, the breach of a term classified as a condition gives rise to a right to terminate the contract subject to the election by the non-breaching party and, in addition, entitles that party to claim for damages[4]. To the contrary, a warranty is a term of contract of less essence and substantiality. A breach of a warranty does not give rise to terminate the contract but entitles only for compensation of damages accordingly.[5] These consequences of a breach of such terms were historically recognised by the common law, and the categorisation was preserved by statutory definition, first undertaken in the *Sale of Goods Act 1893*.
The common law authorities did not dispute the consequences of the breaches in each category, these were clearly described. Problems arose to determine when a term has to be treated as condition and when not.
The analysis of a contract term starts usually with the examination of the intention of the parties. Where the parties expressed their intention clearly enough, the court are not faced with any difficulty to determine the nature of the term as a condition or warranty. Blackburn J stated in *Bettini v Gye*[6]: "*Parties may think some matter, apparently of very little importance, essential. If they sufficiently express the intention to make it a condition precedent, it will be one…*" It can be derived from that statement that the importance of the matter covered by the

[1] See *Behn v. Burness*, (1863) 32 LJQB 204.
[2] *Bowes v Chaleyer* (1923) HCA 15; (1923) 32 CLR 159 (11 May 1923)
[3] *Lowber v Bangs*, (1864) 69 US. 728, the US Supreme court followed expressly. *Behn v. Burness*
[4] *Lombard North v Butterworth* (1987) 1 QB 727
[5] *Associated Newspapers Ltd. v Bancks* (1951) 83 CLR 322 (High Court of Australia)
[6] *Bettini v Gye* (1876) 1 QBD 183

contractual term has no relevance for the categorisation where the parties mutually agreed on the character of the term, and, therewith, on the consequences of a breach of such term.
In the absence of such express declaration, the court looks to the whole contract to see whether the particular stipulation goes *"to the root of the matter, so that a failure to perform it would render the performance of the rest of the contract ……..a thing different in substance from what the parties have stipulated for, or whether it merely partially affects it and may be compensated for in damages."*[7]. The court must ascertain the intention of the parties to be collected from the instrument[8] and the circumstances legally admissible in evidence.
If it can be determined the terms as a condition, as for the consequence of termination it neither is relevant whether the breaching party acted faulty nor whether the non-breaching party suffered any loss.

2. The Case: *Hongkong Fir Shipping Co. Ltd. V Kawasaki Kisen Kaisha Ltd*[9].

The parties agreed a charterparty for a period of 24 month under the contractual term that the vessel (the "Hongkong Fir") "*being in every way fitted for ordinary cargo service."* (the seaworthiness clause). The first cargo took place but due to some engine problems, caused by undermanned and inefficient staff, the vessel arrived with serious delays to the final port. The charterer declared the contract as repudiated, the shipowner claimed for damages. Sellers LJ, Upjohn LJ and Diplock LJ came by differing reasoning to the conclusion that the seaworthiness was not a condition and, therefore, the shipowner was entitled to damages for unjustified repudiation of contract by the charterer.
Sellers LJ points out: "*The formula for deciding whether a stipulation is a condition or a warranty is well recognised, the difficulty is its application."* Under application of the "formula", Seller LJ came to the conclusion that a warranty of seaworthiness was agreed and the charterer had no right to repudiate: "*Ships have been held unseaworthy in a variety of ways……It would be unthinkable that all the relatively trivial matters which have been held to be unseaworthiness could be regarded as conditions…Many events of unseaworthiness can be rectified as the voyage proceeds, so that the vessel becomes seaworthy, It was not contended that the maintenance clause is so fundamental as to amount a condition of the contract. It is a warranty which sounds in damages."*

Upjohn LJ came to the same conclusion that the seaworthiness clause was not a condition:
"*she (the vessel) being in every way fitted for ordinary cargo service"* is a so basic clause that this obligation to bring a vessel which is fit to meet the perils of the sea (seaworthiness) is an obligation that unless there is an express clause of exclusion, it will be implied where not expressed. The seaworthiness clauses cannot be treated as condition in fact because it is breached by the slightest failure to be fitted "*in every way for service, e.g. if a nail is missing from one of the timbers of a wooden vessel or if proper medical supplies or two anchors are not on board"*.

Upjohn LJ did not expressively conclude that the clause was to be treated as warranty. Moreover, he concluded: "*Where, upon true construction of the contract, the parties have not made a particular stipulation a condition, it would be unsound and misleading to conclude that, being a warranty, damages is a sufficient remedy. Such remedies depend entirely upon the nature of the breach and its foreseeable consequences"* Herewith, Upjohn expressed, that even if a stipulation is a warranty, remedies in addition to the compensation of damages are thinkable. It is not clear whether Upjohn LJ had in mind to consider that even a breach of a

[7] Blackburn J in *Bettini v Gye*, (1876) 1 QBD 183
[8] Bowen J in *Bentsen v Taylor Sons & Co.*, (1893) QBD 274
[9] *Hongkong Fir Shipping Co. Ltd. V Kawasaki Kisen Kaisha Ltd* (1962) 1 All ER 474

warranty could lead to repudiation of the contract. The statement of Upjohn LJ indicates that he did rather tend to a category of innominate terms by the remark: "*the decision whether the stipulation is a condition or warranty may not provide the complete answer*." Unfortunately, Upjohn LJ refrained from explaining what sort of remedy in relation to a warranty he had in mind, where *"a breach of a warranty is not sufficiently compensated by payment of damages"*.
A complete understanding why Upjohn LJ meant that the classification into stipulations as conditions or warranty is not sufficient and does not deliver "*the complete answer*" cannot be drawn from the reasoning. Insofar, the reasoning presented by Upjohn LJ is not satisfying.

Diplock LJ drew the same conclusion that only in simple cases or simple circumstances the distinction between condition and warranty provides an instrument to resolve the question under which circumstances a party is relieved of his undertaking to do that which he has agreed to do. But where the contractual undertakings are more complex and where neither the parties agreed to a condition or warranty expressly, nor a statutory definition classifies the stipulation by implication as a condition, "*the court has to adopt the test whether the event deprives the party who has further undertakings still to perform of substantially the whole benefit which it was the intention…that he should obtain as the consideration for performing those undertakings"*.
Diplocks justifies the necessity of the test because complex undertakings which are not undertaken as agreed and, therefore, caused a breach of a stipulation, do in certain cases deprive the benefit of the whole to the innocent party, or in other cases do not. In other words, Diplock LJ denies that the classification does in every case meet the intentions of the parties in respect of the consequences which the parties wished to give in case of a breach of a certain stipulation. Therewith, Diplock LJ created a third category of contractual terms in this regard, "innominal terms", or as also referred to, "intermediate terms", the importance of which lies somewhere between a condition and a warranty.[10]
Diplock LJ held that the unseaworthiness of the Hongkong Fir went not to the root of the contract because the contract contained a clause which excluded the responsibility of the shipowner for delays due to unseaworthiness in an due diligence clause. Diplock LJ concluded that the contract showed itself, that delays or certain kinds of unseaworthiness were not treated by the contract as substantial and, therefore, the charterer could not be deprived of the whole benefit. Hence, although the vessel was not seaworthy for a substantial time and the shipowner was therefore in breach of the respective contractual stipulation, Diplock LJ came to the conclusion that the event of unseaworthiness was breach of the stipulation qualified as innominate term which had not substantial quality. Diplock LJ considered insofar the period of the charterparty where further 17 month left to be performed. The charterer could not treat the contract as at an end because the event of temporary unseaworthiness was not, from its nature, so serious that the charterer was deprived of substantially the whole benefit which he was intended that he should obtain.
Therewith, Diplock provides more flexibility to treat breaches of contract having a look at the nature of the event to which the breach gives rise and the consequences which result of the breach.

3. Discussion

Diplock´s main argument against the classification is that - in the case of a condition - very trivial occurrences as well as serious defects such as a total loss of the vessel are treated in the same way, providing to the charterer the right to elect whether to treat the contract as at an

[10] Carter, Peden, Tollhurst: Contract Law in Australia , 5th ed. 13-09

end or not. Diplock LJ found it worth to reflect the consequences of the breach to reach a flexible and just decision: "*It is like so many other contractual terms an undertaking one breach of which may give rise to an event which relieves the charterer of further performance of his undertakings ….and another breach of which may not give rise to such an event but entitle him only to monetary compensation"*. The legal argument behind the reasoning is flexibility and justice for the single case.
Under the ancient classification system inflexibility arises as the contractual term must be construed as it was intended at the moment of formation of the contract. No actual breach can be considered but at the best the court can consider possible breaches.[11] By the way of construction, the court undertakes to give the stipulation the true weight as the courts mean the parties did intent to give to that stipulation.
The advantage of Diplock´s approach lies in the opportunity provided to the court to consider also the development of the contractual relationship. If the result of construction does not come to the conclusion that any breach of the stipulation goes to the root of the contract (condition), then the court can qualify the stipulation as a mere warranty or an innominate term, the latter giving the option to repudiate where the stipulation is of substantive nature.
In my opinion, it is not of very relevance whether the third category of innominate terms are used to give the single case more justice and flexibility or whether Upjohn LJ is to be followed who seems to consider a right to repudiate where a warranty is breached (*see Hongkong Fir v Kawasaki*). The outcome of both approaches as appropriate instruments to provide greater flexibility appears to be the same because a right to repudiate is granted to the innocent party although the stipulation in dispute is not qualified as a condition and, however, the contract is not frustrated or any other instrument of law which would entitle to repudiation can be applied.

Even supporter of the old classification refer to the necessity of consideration of the element of justice, see Megaw LJ in *The Mihalis Angelos*: "*Where justice does not require greater flexibility, there is everything to be said for, and nothing against, a degree of rigidity in legal principle"*.[12] Megaw LJ reflects the rigidity which results of the bipartite classification, namely the strict consequences of a breach of a stipulation qualified as a condition. It is acceptable that the parties face such rigid consequences where they agreed expressly to the consequences by an express wording, naming a condition a condition. But where the parties omitted to do so, and, therefore, it is on the court to find out the intention the parties may have had at the time of formation by the way of construction, the court should have an instrument on hand which allows greater flexibility by regarding the actual breach.

Megaw LJ criticises in *Bunge v Tradax*[13] that the application of Diplock´s test leads to the result that conditions would no longer exist in the English Law because "*it always being possible to suggest hypothetically some minor breach of any contractual term being wholly insufficient to produce serious effects for the innocent party"*. This statement neglects the first step of Diplock´s test, who admits that the parties may agree on a condition expressly. Furthermore, the opinion expressed by Megaw LJ does ignore the developments of Diplock´s approach. Diplock was understood as accepting the two types of stipulations in the form of conditions and warranties as established over centuries at least in cases "*there are many simple contractual undertakings, sometimes express, but more often…to be implied, of which it can be predicated that every breach of such an undertaking must give rise……to deprive the party not in default of substantially the whole benefit…And such a stipulation….., is a*

[11] Carter, Peden, Tollhurst: Contract Law in Australia , 5th ed . 13-06
[12] *Maredelanto Compania Naviera SA v Bergbau-Handel GmbH, (The Mihalis Angelos)* (1971) 1 QB 164 (CA)
[13] *Bunge Corp. V Tradax SA* (1981) 2 All ER 513

condition." So, Diplock does not deny the further existence of conditions and warranties, but adds simply a third category. Megaw´s critic is not justified insofar.

Megaw LJ criticised further in *Bunge v. Tradax*, that the parties would be "*forced to make critical decisions by trying to anticipate how serious, in the view of arbitrators or courts in later years, the consequences of the breach will retrospectively be seen to have been, in the light, it may be, of hindsight"*. This argument must fail too. Where the parties did not express their intention to agree on a condition, it is of no difference if a court or arbitrator decides in a dispute a long time after the parties concluded the contract, performed partly perhaps, and made urgent decisions (e.g. to declare to treat the contract as repudiated) whether the stipulation was a condition or was not. The parties to a contract will never have an absolute predictability whether a term will be treated as a condition or not as it is always on the court to construe the contract as a whole. The need to make difficult decisions which could later be viewed different by a court or arbitrator is immanent to every legal relationship. It is thinkable that a term will be classified as condition in first instance and, to the contrary, this judgement is not accepted by the Court of Appeal for instance.

Beside this procedural argument, from a viewpoint of the substantial law, the classification into "conditions" and "warranties" is not very useful as the term in dispute can be important in one situation, but is not in another.[14] For instance, the term "*Seller shall notify to the Buyer in the event that the products are not available at Buyer´s plants as agreed",* can be of different relevance in respect of the disability to manufacture or the disability to deliver. Problems with the latter may be solvable very fast by the choice of an alternative kind or way of transport whilst manufacture problems might not to be solved so easily if they are caused by a serious breakdown of specific machinery at seller´s plant the repair of it would take several weeks. The notification could be of very substantial relevance in the latter situation whereas it might not have the same substantiality if the difficulties to transport were caused by the loss of one of Seller´s trucks in an accident before shipment of the products and, perhaps, a resulting delay of two days.

Another difficulty arises from the classification where a contractual stipulation creates several obligations. If so, the test whether a condition was agreed or not must be applied to each single obligation rather than for the whole term. Therefore, the classification can be different for the same term depending on the kind of the single obligation.

It is alleged that the creation of innominal terms as third category causes uncertainty and disturbs predictability. This point of view reflects primarily the assumption that the classification of "condition" or "warranty" prevents the parties from the difficulties to make a decision whether to treat the contract as terminated at the moment when the breach of the stipulation in dispute occurs. The classification appears to be able to provide certainty, where the parties have agreed expressly to the character of the stipulation. Certainty is not in doubt where a stipulation was named a "condition" and, in order to support the technical meaning, the definition section of the contract defines that a "condition shall mean any stipulation in this contract the breach of which gives rise to treat the contract as repudiated". In that case the parties might be quite certain that the breach of the stipulation named a condition entitles the innocent party to repudiation.
But where the agreement does not use such clear wording, the situation is much more complicated even under the classification system (condition v warranty), as the case *Schuler AG v Wickmann*[15] illustrates. There, Wickmanns obligation to visit some key customers of

[14] Carter, Peden, Tollhurst: Contract Law in Australia , 5th ed, 13-06
[15] *L. Schuler AG v Wickmann Machine Tool Sales Ltd.* (1974) AC 235

Schuler AG at least once a week was described: "*It shall be a condition of this agreement to visit…"* Despite of this clear wording, the House of Lords treated the stipulation as a warranty having a look at the contract as a whole, considering the purpose of the stipulation and the consequences of breach of this obligation.
Lord Reid considered that the word "condition" is often used in a less stringent than the technical legal sense, e.g. the state of affairs. Regarding the purpose of the stipulation he came to the conclusion that one missing visit could not justify the repudiation of the contract as a whole. Furthermore, Lord Reid considered with regard to the consequences "*that it is not contented that failures to make visits amounted in themselves to fundamental breaches."*
Therewith, the *Schuler AG v Wickmann* case shows that the parties do not reach a definite certainty even if they agree expressly that a certain stipulation shall be a condition.

The complications increase where parties did not express their intentions at all and, therefore, it is on the court to determine whether the parties have intent to agree on a condition or a warranty. In the due course of construction, the courts consider whether a breach of the stipulation would go to the root of the contract. That means that the court looks whether the obligations created by the stipulation are substantial to the contract or not.
Under the aspect of certainty, it is not predictable which outcome the court reaches by the way of construction. The degree of certainty is insofar not different whether the court undertakes to classify the stipulation into two categories of condition or warranty, or whether the classification into a third category as an innominate term is possible.
Therefore, the creation of innominate terms in Hongkong Fir does not affect the certainty of the parties regarding the drafting and the performance of a contract. As the courts draw their conclusion whether the parties have intent to agree on a condition or a warranty also under consideration of the surrounding interests, the determination what effect the breach of the stipulation shall have is on the courts where the parties did not make sure to express their understanding clearly enough. Not seldom, courts tend to argue from the viewpoint whether a condition leads to an reasonable result of the dispute or not (see e.g. Rix LJ in B.S. & N. Ltd. (BVI) v. Micado Shipping Ltd. (Malta), (The "Seaflower")[16]: "*the reality is the uncertainty which hangs over this charter if the 60 day term is not a condition.…*" This view shows that the courts even under application of the bipartite classification have a look at the consequences of the qualification of the term in the special case. It can be concluded that certainty is not affected by a third category where the parties did not express in the contract itself which character a certain provision shall have.

A last argument of Megaw in *Bunge v Tradax* shall be considered: Megaw LJ discussed the issue that the right to elect whether to treat a contract as at an end or not on the innocent party would be "*a legal fiction, if the election can arise only in circumstances in which……..…the a party will be deprived of substantially the whole benefit. ……For a right to elect to continue the contract by the innocent party…..when he will have lost substantially all his benefit under the contract, does not appear to me to make sense."* It can be admitted that the argument appears to be stringent in the most cases despite it is thinkable that in some cases the innocent party may choose to continue even though a right to repudiate exists. But the main issue against the view of Megaw LJ is that the same situation can arise under the bipartite classification system. Where a term is qualified as a condition because a breach of the stipulation is construed to give rise to repudiate the contract, the same situation arises. The innocent party is faced with the need to make a decision whether to elect to repudiate or not as the qualification as condition does not bring the contract to an end automatically. A

[16] *B.S. & N. Ltd. (BVI) v. Micado Shipping Ltd. (Malta), (The "Seaflower"),* (2001) 1 Lloyd's Rep. 341

substantial difference to the qualification as an innominate term does not exist insofar.

4. Conclusion

The existence of innominate terms was recognised by the English courts serveral times after Hong Kong Fir (see *Cehave NV v Bremer Handelsgesellschaft mbH*[17] for a clause "shipped in good condition", applied to a sale of goods under the Sales of Goods Act under reference that the Act was intended to codify the common law; see Megaw LJ in general in *Bunge Corp. v. Tradax SA*[18], who accepted that unseaworthiness usually will be qualified as such innominate term; *Friends Provident Life & Pensions Ltd v. Sirius International Insurance*[19]*).*
This broad acceptance of the existence of innominate terms and the arguments discussed above show that such category does not affect the uncertainty and predictability of a contract.

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[17] *Cehave NV v Bremer Handelsgesellschaft mbH (The Hansa Nord)[1976] QB 44*
[18] *Bunge Corp. V Tradax SA* (1981) 2 All ER 515
[19] *Friends Provident Life & Pensions Ltd v. Sirius International Insurance* (2005) EWCA Civ 601)